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SOUTHERN COMPANY
Energy to Serve Your World℠

May 7, 1997

Congressman John D. Dingell
Committee on Commerce
U. S. House of Representatives
Room 2125, Rayburn House Office Building
Washington, D.C. 20515-6115

Dear Congressman Dingell:

Thank you for the opportunity to share our insight and perspective about the various issues identified in your April 10, 1997, letter to me. I'm sure you, more than most, appreciate the complexity of these issues. We have tried to strike a balance between responsiveness and brevity in the attached response.

I shall look forward to an opportunity to continue our discussions on these most important issues.

Yours truly,

Dingell's Questions and Responses

-DRAFT-

1. **From your company's point of view, is it necessary for Congress to enact legislation bearing on retail competition, and why? If you favor legislation, please outline which issues should be addressed and how you think they should be resolved.**

It is not necessary for Congress to enact legislation bearing on retail competition. Southern Company believes the issue of retail access in electricity markets is one that should be addressed by the state public policy makers. A one size fits all solution mandated by the Congress would preempt traditional state authority over retail electricity policy. Currently, 49 states are examining this issue. Some states have passed legislation calling for retail competition, others have adopted pilot programs and still others, like Mississippi and Georgia, are conducting hearings to investigate the issue in more detail. States with high electricity rates, like California and New Hampshire, were the first to act, however now moderate and low cost states like Oklahoma and Montana have passed retail access legislation. If customer choice is the ultimate goal by public policy makers, the best laboratory for the development of such a plan is on the state level.

There is a role for the Congress in a transition to competitive electricity markets, and that is to remove any federal barriers that may hinder or restrict the development of these markets. Congress is uniquely qualified to address the following issues:

1. Assure that there is clear state authority to mandate retail competition.
2. Clarify the boundaries between federal and state jurisdiction over retail transmission and distribution.
3. Ensure that states have the ability to impose reciprocity requirements.
4. Ensure fair and efficient competition by eliminating the ability of government-owned and cooperative utilities to use federal subsidies and preferences for advantage in competitive markets.
5. Repeal the Public Utility Holding Company Act (PUHCA) and the Public Utility Regulatory Policies Act (PURPA).

Congress should pass federal legislation dealing with those issues that only it can resolve, and leave the timing and details of retail competition implementation to the states.

2. **If the state(s) you serve has adopted or is considering adopting retail competition, what are your biggest concerns? Please be specific. Indicate how you are dealing with them and any recommendations you may have.**

Southern Company provides retail electric service in four states -- Alabama, Florida, Georgia, and Mississippi. None of these states has yet adopted retail competition. Alabama has had legislation introduced, Florida has an ongoing public service commission study, Georgia's public service commission has initiated a series of workshops on the subject, and Mississippi has started hearings in a restructuring docket. Thus, all four states have initiated consideration of the issues in adopting retail competition.

Southern Company's many concerns, as states proceed in their consideration of electric restructuring, include:

- market structure -- How should the market be structured? Should it be a competitive pool from which customers can buy directly, or can customers be allowed to sign whatever deal they want?
- timing -- Over what period should retail competition be phased in, given economic and technical constraints?
- cost shifting -- How does the state preclude competition from being used as a means to unfairly shift costs from one class of customers to another?
- stranded cost recovery -- We believe that utilities should have the right to collect prudently incurred costs which were incurred to meet their contractual or legal obligations to serve customers within their franchise service area. Determining what costs are eligible for recovery, how they should be quantified, and over what time period and how they should be collected are all critical issues to address as a part of the decision to allow recovery.
- public policy programs -- Over the years, utilities have assumed a public service role within the states and localities in which they operate. This includes assistance to low income customers, public good research and development, special conservation and environmental programs, and others. If these programs are to be continued in a competitive world, new mechanisms may have to be found to pay for them that does not impose all of the burden on any single market participant
- reliability -- While competition need not harm reliability of the system, special care must be taken to ensure that the current system of voluntary coordination is enhanced as appropriate. Reliability and

quality of supply to the customer must not be lowered during the transition.

- state and local taxes -- this is one of the most important issues, and one that will require time and careful attention in the states. There are really two different types of issues:
    - ⇒ First, there are state taxes which may not be evenly applied to in-state and out-of-state competitors. For example, in Georgia we have a fuel tax, which is applied to in-state generation, but not on power imported from out of state. This would put Georgia suppliers at a competitive disadvantage relative to suppliers in other states, a situation which only state governments can remedy.
    - ⇒ Second, retail competition could have a substantial impact on state and local tax collections. If the value of utility property decreases as a result of competition, than tax assessments will also have to decrease, and less revenue will be available to tax. This will be an especially difficult problem for those locales where we have large plants situated. In some of these towns or counties, utilities may provide over 50% of total revenue collection by the local government. Clearly, if these local governments are not to be severely impacted, state legislative action to fix these problems will be needed.
- uneven regulation -- In many states, cooperative utilities and municipal electric systems are not regulated by the Public Service Commission. With the expectation that some regulation will remain in place, it would be unfair to regulate investor-owned utilities differently than cooperatives and municipal utilities. and to provide them other state subsidies or advantages. These utilities also receive some state subsidies and preferences, such as tax exemptions, which would create an unlevel competitive playing field. State legislatures will need to address these issues.
- universal service -- Electricity can no longer be considered a luxury in this day and age -- it is clearly a necessity for all households and businesses in the country. Without a properly implemented transition, low income customers and other smaller customers without the economic clout to find the best deals may be left behind and face increased costs. And while residential customers in densely populated areas, with fairly large bills may be attractive to aggregators, not all customers will be so attractive. States must be allowed to implement a transition to competition which allows for the continuation of universal service at affordable prices and provides a mechanism for all market participants to share fairly in the costs.

- unbundling -- Efficient competitive retail markets, may require the ability for customers to buy generation and other services separately. Utilities' regulatory accounting practices do not provide for easy separation of these costs. New cost accounting systems will need to be developed. Another issue is that there are costs borne by a utility today which can not be ascribed to a particular customer. For example, we currently maintain generation and transmission reserves to keep blackouts at an absolute minimum. Maintaining this level of reliability is currently incorporated in customer rates. If a customer leaves our system to purchase from a competitor, we still bear those costs, and those reserves still benefit the customer. Thus, a mechanism must be found by which all customers share equally in these joint costs of maintaining system reliability regardless of their supplier.
- nuclear safety -- Clearly, it is important that nuclear licensees remain financially viable so that they may safely operate and/or decommission existing nuclear plants. The NRC is required to ensure that this remains the case.
- the Integrated Transmission System -- This is an issue unique to Georgia, but which points out the absolute need for restructuring issues to be left to state determination. Georgia's current jointly-owned transmission model (the Integrated Transmission System or ITS) has generally worked well in the past, but the arrangement may need to be revisited in a world where we are competing against one another for retail customers. Revising the Transmission System Agreement, which took years to formulate initially, will take time and a great deal of effort.

Southern Company does not currently have the answers to how all of these issues can be resolved. These issues must be resolved through a consensus-building process that involves state regulators, customers, and other stakeholders. Otherwise, years of litigation could delay the introduction of increased competition.

3. Whether or not you favor federal legislation, please indicate your position on the following specific issues (to the extent not addressed in your responses):

a. *A federal mandate requiring states to adopt retail competition by a date certain.* If retail competition is under consideration in the state(s) you serve, do you believe Congress should provide additional direction or authority?

Southern Company opposes a Federal mandate requiring states to adopt retail competition by a date certain. Retail electric service has always been and should continue to be an issue for state public policy makers. Each state and region face very different circumstances, and a federally imposed mandate for retail access could result in adverse consequences for both customers and shareholders of the host utility.

As stated above, there are issues related to electric utility restructuring that only the Federal government can resolve. Congress should consider legislation that removes those barriers identified earlier that hamper or restrict competition. Some states are still moving forward with restructuring plans even without Congress acting on these issues. However, such action by the Congress will enhance the work completed by the states and will assist those states considering the implementation of customer choice programs.

b. *Recovery of stranded investment.* **If the state(s) you serve already has adopted retail competition, how was this issue addressed and are you satisfied with the outcome? If your state(s) is considering adopting retail competition, how would you recommend this issue be treated? Do you think Congress should enact legislation relating to stranded cost issues, and if so what would you recommend? Is securitization a useful mechanism for dealing with stranded costs, and whom does it benefit?**

The issue of stranded costs has been addressed most recently in Alabama. State legislation enacted in 1996 gives the regulatory commission (or the courts in the case of cooperative and municipal utilities) the ability to impose stranded costs when a customer, for whom the utility had an obligation to serve, departs for another supplier. This is statutory authority which already exists in other states.

States should allow full recovery of legitimate and unmitigable stranded costs. These were costs incurred under a regulatory compact which required the utility to serve all customers, whether profitable or unprofitable, in a defined service area, in return for which investors were given the opportunity to be assured of a reasonable return on their investment. It would be unfair for government to change the rules in mid-stream and require shareholders to bear these costs. Seventy-five percent (75%) of whom, in Southern's case, are individuals with a median age of 68. Denial of stranded cost recovery will also raise the cost of capital for any future investments made by utility and non-utility power suppliers, resulting in increased electric costs to consumers.

Congress should not mandate either a date certain for retail competition or the terms for stranded cost recovery. However, if Congress forces the states to act within a limited time through a federal date certain, then it is incumbent upon Congress to require the states to allow full stranded cost recovery. If the states have to implement retail competition by a certain date, there is no reason for proponents of retail access to accept any treatment of stranded cost recovery. If Congress adopts a date certain, it must require that states allow full stranded cost recovery, perhaps with a federal (FERC) backstop if a state refuses to allow reasonable recovery.

Securitization is a useful mechanism for dealing with stranded costs, and can benefit both shareholders and customers.

c. ***Reciprocity.*** **Can states condition access to their retail markets on the adoption of retail competition by other states? Should Congress enact such a requirement? Could such a requirement create an incentive for states with low electric rates not to adopt retail competition, in order to keep cheap power at home?**

There is certainly an argument that reciprocity requirements violate the Commerce Clause of the United States Constitution. As you know, a state cannot discriminate against or place an undue burden on interstate commerce. State tax cases and open market cases have recognized this principal for many years. These cases would suggest that one state could not condition entry of out-of-state electricity marketers on the out-of-stater's home state permitting retail competition. To prevail, the host state would have to establish that its reciprocity requirement helped ameliorate the "stranded costs" of an in-state utility either by lessening the competition it faces or by opening new markets to it.

To clear up any ambiguity that may exist with respect to reciprocity requirements, Congress should enact legislation giving states clear authority to require reciprocity if they wish, but such federal legislation should not require states to adopt reciprocity. Any such requirement by Congress would not provide low electric cost states with any <u>more</u> incentive not to adopt retail competition than they would have absent a federal provision giving them authority to require reciprocity. In fact, it is likely to encourage states to adopt retail competition, so that in-state generation can find other markets.

4. **If Congress enacts comprehensive restructuring legislation, should it mandate "unbundling" of local distribution company services? What impact would this have, and would the effects differ for various customer classes? Would this entail substantial expense, and who would incur any such costs?**

Congress should not mandate "unbundling" of local distribution services. Such unbundling would have the potential to create additional stranded costs that would have to be collected from departing or existing customers and could provide additional confusion to customers who will have a difficult enough time determining the differences between alternative generation suppliers. Determining the costs of such unbundled services will be difficult, since most regulatory accounting systems do not lend themselves to activity based accounting. While unbundling would impact all customer classes, the greatest impact would likely be on residential and small business consumers. The decision on whether and when to unbundle local distribution is a decision that should be made by state regulatory agencies, the appropriate forum for resolving retail service issues.

5. **Recently, Chair Moler of the Federal Energy Regulatory Commission recommended that, as part of comprehensive legislation, Congress authorize the Commission to enforce compliance with North American Electric Reliability Council standards to help maintain reliability of service. Do you believe this is necessary, and why or why not?**

Congress should authorize the Commission to enforce compliance with North American Electric Reliability Council standards to help maintain reliability of service. The electric industry supports the adoption of a mandatory system for reliability management of the electric grid. In January 1997, the North American Electric Reliability Council (NERC) Board of Trustees approved the transition to a mandatory system with an obligation to comply for all market participants. The mandatory system for reliability management will cover the operation and planning of the interconnected electric grid and is broadly supported by policy makers, regulators, and industry leaders. Since the North American electric grid covers many jurisdictions and countries, no single regulatory or legislative body action will be sufficient to cover the entire electric grid. Hence, an industry compact by which all players voluntarily subject themselves to abide by a mandatory system for reliability management through contracts, tariffs, licenses, and certifications is the best approach to bring all market participants under a unified reliability umbrella. The role of the Federal Energy Regulatory Commission (FERC) would be to approve contracts and tariffs filed with the Commission that include specific requirements to comply with all NERC reliability standards. The FERC must have the clear authority to approve contracts and tariffs conditioned on compliance with NERC reliability standards and the authority to take whatever actions are necessary to enforce compliance with NERC reliability standards.

6. What concerns does your company have with respect to the role of public power and federal power marketing agencies in an increasingly competitive wholesale electric market? In markets in which retail competition has been adopted? Are there concerns you would like to have addressed if Congress enacts comprehensive restructuring legislation? Should Congress consider changes to federal law as it applies to regulation of public or federal power's transmission obligations?

i. What concerns does your company have with respect to the role of public power and federal power marketing agencies in an increasingly competitive wholesale electric market?

Our concerns fall into two categories: regulation and subsidies.

<u>Regulation</u>

Public power entities (meaning municipal utilities, public utility districts and rural electric cooperatives) and the federal power marketing administrations ("PMAs") are only subject to Federal Energy Regulatory Commission ("FERC") jurisdiction for wholesale transactions over their transmission lines when a complaint is brought against the entity pursuant to Section 211 of the Federal Power Act. This means that public power entities and the PMAs, unlike investor-owned utilities, are not required to file open access tariffs with FERC pursuant to Order 888; nor are they required to participate in the Open Access Same-Time Information System ("OASIS") established by FERC in Order 889.

The effect of this regulatory disparity on the wholesale market is tremendous. Public power entities and the PMAs operate their transmission lines as unregulated monopolies, creating two main problems. First, the efficient flow of wholesale transactions over the transmission grid is often impossible because sections of the grid owned by public power entities and the PMAs are "blacked out." Market participants cannot get the information necessary to execute transactions because the owners of the lines are not required to provide any information about their availability. This often prevents the delivery of power from one entity to another along the most economic path, thus increasing the cost of the transaction. Second, in some areas, wholesale transactions cannot occur because transferring electricity over public power- or PMA-owned transmission lines is the only way to do the deal. Allowing public power entities and the PMAs to inhibit competitive transactions by preventing access to their transmission lines, or charging monopoly rents for their use, should not be allowed by Congress.

Subsidies

The cost of wholesale electricity produced by public power entities and the PMAs is artificially low when compared with investor-owned utilities and independent power producers. This low price is based on subsidies, not efficiencies. These subsidies distort the marketplace and provide public power entities and the PMAs with a competitive advantage.

a. Public Power Entities

The subsidies that public power entities receive are well documented. One study estimates the total annual benefits at nearly $9 billion dollars and breaks them out as follows:

Power Purchases from the PMAs	$2.2 billion
Tax Exempt Financing Benefit	$0.8 billion
Exemption from Other Taxes (i.e., various state and local taxes)	$2.0 billion
Exemption from Federal Income Tax	$3.0 billion
Below Market Loans and Loan Guarantees from the Rural Utilities Service	$0.8 billion
Total	**$8.8 billion**

b. The PMAs

The PMAs' cost of producing power for wholesale transactions is also heavily subsidized by U.S. taxpayers. In September of 1996, the General Accounting Office ("GAO") reported that three of the PMAs (Western, Southwestern and Southeastern) are subsidized by the U.S. taxpayer at an annual rate of over $300 million per year and the billions of dollars over the last 30 years. GAO concluded that the annual $300 million shortfall was the result of the PMAs not recovering all of their power related costs from their customers. To make matters worse, not only is this power below cost, it is substantially below market. In a recent report, the GAO found that PMA power is up to 50 percent cheaper than average wholesale power costs in the various regions where the PMAs operate.

The result of the regulatory advantages and subsidies enjoyed by public power entities and the PMAs has been to create a set of rules for these market participants that conflicts profoundly with the essential purposes of the competitive wholesale energy market Congress sought to establish and nourish when it enacted the Energy Policy Act of 1992. Public power entities and the PMAs currently operate in direct contrast to competitive market principles.

c. TVA

Today, by some measures, the Tennessee Valley Authority is the largest producer of electricity in the United States. The role of TVA must be addressed in any electric utility restructuring legislation.

The TVA Act of 1933 created an independent, government-owned, taxpayer subsidized corporation exempt from most forms of regulation. TVA was not organized to sell electricity, but as a social experiment to uplift the depressed Tennessee Valley region. In connection with that, TVA was authorized to sell "surplus" electricity generated at its dams to cooperative and municipal distributors, direct-served industrials, and federal agencies.

In 1959, Congress passed the TVA Bond Act which both empowered and restricted TVA. TVA was empowered to issue revenue bonds (currently up to $30 billion), but was restricted from using the revenue from those bonds to compete against neighboring utilities. This restriction against TVA competing against neighboring utilities is known as the "Fence". TVA now wants to sell its federally-subsidized power outside the Fence, but not allow others to sell to its customers. TVA's current chairman has stated, "[I]t is all but preordained: the Fence should come down." TVA's actions in the marketplace indicate that it has not waited for Congress to address the issue of the Fence.

Regulation

TVA claims immunity from a broad range of federal laws, ranging from antitrust, to workplace safety, to the internal revenue code. One count estimates that TVA is exempt from over 100 federal laws. TVA also claims immunity from direct regulation by any and all state regulatory authorities. By contrast, shareholder-owned utilities are subject to the full array of laws and regulations. This different regulatory treatment skews the competitive playing field in TVA's favor because they can avoid the costs and burdens of regulatory compliance. Being free from regulatory oversight and accountability also enhances TVA's operational flexibility. For example, TVA is currently exempt from the following: (1) FERC regulation of its rates for electric service and transmission services; (2) FERC regulation of its hydroelectric activities; (3) state regulation over its retail service as well as over its siting and construction of transmission and distribution facilities; (4) state regulation over territories in which electric suppliers render electric service; and (5) state regulation over environmental matters.

One of the federal laws from which TVA is exempt is the Energy Policy Act of 1992 ("EPAct"). During consideration of EPAct, TVA vigorously sought and obtained protection from wholesale competition through passage of Section 212(j). TVA obtained this exemption from EPAct's open access provisions by arguing that Section 212(j) was a fair corollary to TVA's 1959 boundary limitation. Since the Fence prohibited TVA sales outside its service area, TVA argued that it should not be compelled to allow other utilities to provide power within its service area.

Subsidies

As an agency of the federal government, TVA is the recipient of numerous direct and indirect subsidies. An analysis by the international economic and management consulting firm, Putnam Hayes & Bartlett, prepared in August, 1995, and released in February, 1997, quantified those subsidies and competitive advantages at more than $1.2 billion. The subsidies include exemption from Federal and State income taxes, exemption from State and local ad valorem and other taxes, the purchase of federal preference power at subsidized rates, and lower financing costs because its bonds are partially tax exempt.

Despite its poor financial condition, TVA has been afforded an AAA rating on its bonds by Moody's Investment Service and Standard & Poor. This rating, as explained by Moody's, is due to the implied promise by the federal government to come to TVA's rescue in times of fiscal difficulty. The federal government is thus providing the equity backstop for TVA's credit rating and its ability to borrow money at "risk-free" rates of interest.

TVA currently receives approximately $106 million in Congressional appropriations for its "non-power" appropriations. Some of the funds are for activities such as economic development and management of federal dams, reservoirs, and lands -- activities which shareholder-owned utilities must include in their cost of service.

TVA can also take advantage of the federal procurement system for such purchases as fleet vehicles and travel at lower prices than those available to the public.

TVA, as a subsidized federal power authority with all its special privileges, immunities and benefits, must be dealt with in any transition to effective competitive markets.

ii. In markets in which retail competition has been adopted?

States that have implemented retail competition have either left public power entities out of their restructuring plans or allowed them to opt out of the state plan. The result is that suppliers who want to bring cheaper electricity to public power customers will be prevented from doing so and customers of public power entities will not get the benefits of choice.

Even if public power entities choose to opt in to the state restructuring plan, effective competition may be thwarted by a cooperative and or municipal sellers' ability to set their own levels of stranded costs without the input of state or Federal regulators. Similarly, the terms and conditions of access may be established and policed by the cooperatives and municipals in a manner which precludes access. In no uncertain terms, these sellers are already unregulated monopolies. According to the National Association of Regulatory Utility Commissioners, 31 states do not have meaningful jurisdiction over cooperative retail rates, while 41 states lack meaningful jurisdiction over retail municipal rates. Unlike other utilities who will have to reach a settlement on stranded investment with regulators, customers, consumer advocates, environmentalists, low-income advocates and others in an adversarial proceeding, municipal and cooperative systems would be free to set their own stranded costs unilaterally. Cooperatives and municipals setting their own stranded costs means they can ignore state or federal policy directives against cross subsidization, information sharing or other requirements imposed on other monopoly systems that are being deregulated.

Thus, there is a potential that in the overwhelming majority of states, unregulated public power entities may set stranded cost levels "on the wires" so high that access to their customers will be effectively denied. Alternatively, they may provide customer choice with terms and conditions that are unacceptable to either suppliers or consumers (e.g., customer choice but only during times of excess capacity on the system). As a result, the one quarter of American electric consumers served by public power entities could be denied the benefits of competition, or be given a choice that is in effect meaningless.

In addition, state restructuring laws which exempt public power entities from retail competition may raise Commerce Clause issues. State action shielding certain markets from interstate commerce has been found to be in violation of the Commerce Clause of the U.S. Constitution by the U.S. Supreme Court. Insulating public power entities from competition in interstate commerce may prove to be similarly untenable. Accordingly, federal action to eliminate disparities in the treatment of both electric service providers and customers may be necessary.

With regard to the PMAs, their effect on retail competition is felt today in states where preference customers are allowed to compete for new retail load. For the reasons discussed in the answer to the first part of this question, Federal hydropower is significantly cheaper than hydropower produced by private entities. Access to this power creates a competitive advantage for the preference customers. That advantage will only grow if the PMAs continue to operate in a subsidized, unregulated environment and preference customers are allowed to compete for new customers under state restructuring plans that do not require that all electricity suppliers be treated under the same set of regulations.

iii. Are there concerns that you would like to have addressed if Congress enacts comprehensive restructuring legislation?

Yes. Comprehensive Federal restructuring legislation should include the following concepts with regard to public power entities and the PMAs:

- Supplier parity, meaning that all electricity sellers – municipals, cooperatives, investor-owned utilities and independent generators – must be treated equally under the law. This means that, at a minimum:

    - Federal programs that favor certain suppliers and disadvantage others must be eliminated (see the programs outlined in **section i** of this question); and,
    - Federal and state regulation of all competitors must be uniform. There should be no special exemptions from Federal or state regulation for certain classes of suppliers (as there are now for public power entities and the PMAs).

- Consumer parity, meaning that *all* consumers, whether served by a public power entity or an investor-owned utility should be given a meaningful right to choose among competing electric suppliers. This means that, at a minimum:

    - Every consumer in state should have the right to access local distribution facilities on a comparable basis to any other consumer in the state; and,
    - Every consumer should have a federal right of action to enforce their right to access local distribution facilities on a comparable basis.

- Public power entities should have the option to have their stranded costs determined by the state commission in a "Safe Harbor" proceeding. If a public power entity participates in such "Safe Harbor" proceeding, they would be shielded from the comparability lawsuit described above.

- If a state failed to implement a plan for universal access to all electric distribution systems and provide all customers the opportunity to choose their electric service supplier, FERC should have the authority to implement such a plan.

iv. Should Congress consider changes to federal law as it applies to regulation of public or federal power's transmission obligations?

Yes. Congress should subject all public power and PMA transmission lines to FERC open access requirements and regulation. This should be done without delay, whether or not Congress enacts comprehensive restructuring legislation. Without this change, a fully competitive wholesale market cannot become a reality.

7. If Congress enacts comprehensive restructuring legislation, should changes be made to federal, state, or local tax codes, and if so why? Please be specific.

Federal tax laws should be amended to remove artificial preferences, subsidies or impediments to equal tax treatment for all retail electric competitors. The nature of these changes depends upon the type of restructuring which occurs. For example, if municipal distribution systems are permitted to compete outside their city limits for customers of private utilities, they should only be permitted to do so through conventionally financed facilities (not tax-free municipal bonds), and they should pay federal income taxes on the revenues derived from such sales.

To assure fair, efficient, even-handed competition and to prevent revenue erosion, even more changes will probably be required at the state and local level. Most states and local governments derive significant revenues from some or all of the following forms of taxation of private utilities:

- Gross receipts tax. A majority of states apply a gross receipts tax on the sale of electricity by private utilities.
- If a state does not utilize a gross receipts tax, it typically imposes a corporate franchise or state income tax.
- Ad valorem taxes. Most states impose state and/or local property taxes on private utilities.
- Sales and use tax. Nearly all states apply their sales tax to the sale of electricity. A few states, such as Georgia, also tax the fuel burned at power plants located in the state.
- Utility user tax. Some states collect an electricity tax from end users based on the amount of consumption.
- Franchise fee or business license fee. License fees tend to be pure revenue producers. In some states, cities exact gross receipts franchise

fees for permitting utilities to locate poles and wires on public rights-of-way.

- Regulatory fees. Many states impose taxes or charges on regulated utilities to cover some or all of the costs of regulatory agencies, consumer advocates and in some states, intervenors.

As the identity and type of power marketers and the sources of power generation change, each state will have to examine its own state and local revenue laws to assure fair competition and appropriate revenue production.

8. What, if any, concerns do you have about the reliability of the electric system? If the industry moved to retail competition, will adequate reserves be available? Is the transmission system capable of handling full retail competition?

FERC Orders 888 and 889 issued in April 1996 required jurisdictional utilities to file open access transmission tariffs, functionally separate transmission planning and operations and wholesale power marketing, implement strict standards of conduct, and calculate available transfer capability (ATC) for posting on the newly developed Open Access Same-Time Information System (OASIS). These requirements make this a challenging time to operate and plan the electric grid and raise concerns regarding the continued reliability of the electric grid.

With increased competition, the number of transmission system users will increase dramatically and the coordinated control of the electric grid will become more difficult. With the increased number of wheeling transactions, the impact of loop flows will become more significant, the responsibility for controlling the level of loop flows will become more difficult to assign, and the means to mitigate the increase of loop flows will become more difficult to implement. For example, substantial problems can occur when different parties request transmission service within a short time interval from different transmission providers over different transmission paths where the transactions have a substantial impact on both transmission paths.

Increased transmission access has also increased the complexity and uncertainty associated with the planning of the electric grid. Transmission planners must deal regularly with all of the uncertainties of future loads, generation sources, network configurations and power flows. Transmission systems are planned, using carefully developed criteria and guidelines, to accommodate all known or planned firm transactions on the interconnected electric grid. However, a utility cannot plan its transmission system to accommodate the myriad of possible non-firm (economy) transactions that will occur with increased competition. This will result in increased pressure on system operators to maintain reliability as transmission line loadings increase.

In order to ensure a reliable grid to support an open market in electric energy, all market participants, not just transmission providers, must adhere to reliability policies and standards for the system to work. NERC members must quickly develop the policies and standards required to maintain reliability and develop a formal mechanism to monitor compliance. NERC members must aggressively and rapidly adopt these changes in order to keep pace with the accelerating demands of the marketplace. As stated above, FERC must have the authority to take whatever actions are necessary to enforce compliance with NERC reliability standards.

If the industry moved to retail competition, there is no certainty that adequate generation reserves would be available. As the market develops, there may be a reluctance by utilities to build new generation and a trend toward buying options to meet firm resource requirements. Therefore, the overall adequacy of generation will be difficult to determine. Until the perfect marketplace exists with real time customer response to price signals, the economic principle of rapid demand reductions in response to high price signals will not function to preserve the reliability of the electric system. In the long term, new generation will be added when price signals indicate that it is economic to do so. In the transition, NERC must continue to play a role in ensuring the adequacy of generating resources.

The current transmission system may not be capable of handling full retail competition. It is, however, capable of handling some amount of retail competition, which will vary by transmission provider. Transmission systems have been developed to connect the generating plants to the distribution systems and to connect utilities together to enhance reliability and provide a means to exchange a limited amount of electricity. Transmission systems have not been developed, in most cases, to ship large amounts of power across, out of, or into a geographic region. Therefore, it is doubtful that the transmission system is robust enough to allow all customers to benefit from full retail competition immediately. In the long term, of course, there is the likelihood that transmission improvements would be made and more efficient generating plants would be built in the region.

9. If Congress enacts legislation on retail competition, should changes to the Public Utility Company Holding Act of 193 5 (PUHCA) be included? If so, what would you recommend? In particular, how should Congress address

market power Concerns in any such legislation? Are transition rules needed during the period before effective competition becomes a reality?

Southern supports repeal of PUHCA whether or not Congress enacts legislation on retail competition. Moreover, repeal of PUHCA would, in and of itself, promote competition and thereby produce likely benefits for consumers and investors alike. Hence, if increased competition is the central policy consideration in the current energy debate -- there is no benefit in delaying PUHCA repeal pending resolution of all of the complex regulatory and technical issues surrounding retail access. Southern supports PUHCA repeal legislation that reinforces and enhances access to books and records in order to ensure adequate protection to consumers.

The full benefits of retail competition cannot be achieved without changes that would also lead to the elimination of structural inefficiencies that now exist in the electric industry due in large measure to PUHCA. PUHCA perpetuates structural inefficiencies in two ways. First, PUHCA effectively prevents many acquisitive-type structural changes (mergers, formation of new multi-state holding companies, etc.) from taking place, even though economies and efficiencies can be demonstrated. Second, to the extent that Congress or the states enact legislation designed to force the break-up of vertically integrated utilities through asset sales, spin-offs or the like ("disaggregation"), PUHCA will be an obstacle to the full realization of that goal. This is because many potential investors, including non-traditional investors (i.e., new entrants), will be disinclined to invest in an industry if, as a result, they would become subject to adverse regulation as "holding companies" and/or be limited geographically in their operations.

If PUHCA is not repealed outright, any legislation enacted by Congress on retail competition should, at a minimum, include relief from the integration requirements of Section 11(b)(1) of PUHCA. It is the integration requirement of PUHCA that currently locks registered holding company systems into a structure of concentrated vertical ownership within a single geographic area or region based on the premise, which is now largely discredited, that consumers and investors alike reap the greatest benefits where the holding company owner of a multi-state system is confined to one region. Further, it is this provision of PUHCA that will limit new market entrants who, for a variety of business reasons, would choose to organize as holding companies.

PUHCA also artificially limits the operations of so-called "power marketers." The SEC treats power marketers as non-utilities, but only if they do not acquire and hold physical electric assets. Hence, under PUHCA, the owner of a marketer is not a "holding company," and even a registered holding company, like Southern, is not limited by the integration standards from acting as a marketer outside its franchised utility area. In the future, however, it seems likely that power marketers will want to build or install some types of physical assets which, for purposes of PUHCA. would be classified as "utility assets." If they do, they would lose their status as non-utilities and the limits of PUHCA would apply.

There is no obvious need for Congress to address market power in the context of legislation amending PUHCA along the lines suggested for at least two reasons. First, elimination of the integration standard would, if anything, lead to less concentrated control in the electric utility industry in that future acquisitions by registered holding companies would not have to be confined to a single region. Moreover, it would remove a significant barrier to new market entrants. Second, the issues of market power are already subject to comprehensive review by FERC and the Department of Justice in the context of merger applications. There is no compelling reason why a third federal agency -- the SEC -- whose expertise is primarily in regulation of the financial markets, needs to pass on the same issues.

Finally, the continuing existence of PUHCA already limits competition that would otherwise naturally evolve through industry restructuring (i.e., mergers, disaggregation, and ownership of utility assets by new entrants and power marketers), we see no purpose served by including transition or phase-in rules on PUHCA repeal or reform in legislation on retail competition.

10. To what degree, if any, have recent Securities and Exchange Commission administrative orders and Rule 58 decreased the need for legislative changes to PUHCA? Assuming these actions withstand any court challenges, what are your major remaining concerns about the Act?

In recent administrative actions, including the adoption of Rule 58, the SEC has provided a useful measure of relief from overly restrictive interpretations of PUHCA that have either prevented registered holding companies from engaging in other energy-related businesses, or have limited such operations geographically. The principal benefit of Rule 58 is that it eliminates the geographical restrictions on certain enumerated non-utility businesses. It will also likely eliminate the need to file routine applications seeking approval to engage in businesses which the SEC has already found to satisfy the standards of PUHCA in other cases.

It should be noted that the list of permitted activities included in Rule 58 is selective. There are many activities which Southern considers "utility-related" in the broader sense of the term, even though not related to energy.

Examples include water distribution, certain types of facilities management activities, factoring of accounts receivable, and natural gas production and transportation, which are either not included among the permitted activities under Rule 58 or, to the extent that they are included, apply only to registered gas utility holding companies. Thus, it would be premature to conclude that Rule 58 has eliminated PUHCA as an obstacle to investments by registered holding companies in many types of related businesses.

If Rule 58 does not exempt a particular non-utility activity that Southern may wish to engage in, then we will continue to be at a significant competitive disadvantage to other utilities, including exempt holding companies, in terms of the attendant delay involved in seeking SEC approval for a particular new business venture. Further, under Rule 58, as well as most of the individual orders issued by the SEC, registered holding companies are obligated to file detailed reports on each particular business venture with the SEC and with each applicable State public service commission. These reports are primarily designed to aid state commissions in protecting consumers from the effects of cross-subsidization and abusive affiliate transactions. However, these reports typically call for detailed disclosure of financial and other operating results that goes well beyond any possible needs of state regulators and impose a significant expense on registered holding companies to which its competitors are not subject. Moreover, although the SEC permits registered holding companies to claim confidential treatment for these reports -- in order to protect them from disclosure to competitors -- it is not clear that the States have similar procedures for confidential treatment of proprietary, non-public, information. The registered holding companies are in effect forced to make disclosures of information that could be of interest only to competitors.

11. As electricity markets have become more competitive, some have asserted that PUHCA prevents consumers from receiving the full benefit of competition. Do you agree or disagree, and why? Is competition in wholesale or retail electric markets dependent upon the participation of the registered holding companies? Is it a certainty that changes to PUHCA would enhance actual competition? Please provide specific examples to illustrate your answers.

As indicated in response to question 9, PUHCA imposes artificial structural, or organizational restrictions on ownership of utility assets through subsidiaries which are no longer perceived as necessary or desirable in today's rapidly changing energy industry and which prevent consumers from receiving the full benefit of increased competition that would otherwise result from structural changes in the in the industry via mergers, disaggregation, and new market entrants. Further, the integration standard under PUHCA places registered holding companies at a significant disadvantage vis-à-vis other utilities, including exempt holding companies, because it precludes the operation of both gas and electric operations in the same holding company system and may prevent or limit a registered holding company from acquiring and owning gas production or transportation operations. Thus, it is unlikely, under existing interpretations of PUHCA, that a registered holding company could be involved in the kind of merger currently planned by Enron and Portland GE, Duke Power and PanEnergy, Brooklyn Union and LILCO, or Houston Industries and NORAM, all of which appear to have been undertaken in order to enhance the competitive position of those companies in the increasingly integrated natural gas/electricity markets,

It is clear that the elimination of artificial barriers on the current structure of the electric industry would at least create conditions under which actual competition would be likely to evolve.

12. Do registered holding companies face unique problems if some states they serve adopt retail competition and some do not?

Under PUHCA, the SEC plays no regulatory role in the operational aspects of public utility operations. It does not have authority over rates or rate design, construction programs, or fuel procurement practices. These issues are already the exclusive province of FERC and the state commissions. Accordingly, Southern would not expect that registered holding companies operating through subsidiaries in several different states would face problems that are any different than those faced by free-standing utility companies with operations in more than one state or exempt holding companies. Specifically, Southern would not expect that the actions of one state with respect to retail competition would necessarily have any "spill-over" effect in any other state.

13. How do the various retail competition proposals presently pending before the Congress affect decisions regarding stranded costs for registered holding companies? Do you support any of the formulations in these bills? Do you have alternate recommendations on this or other issues unique to registered holding companies if Congress enacts retail competition legislation?